
Tax Advantage on Muni Bonds Disappears as Prices Hit Record High.

- **After-tax, Treasuries yield more than some muni bonds**
- **Influx of cash breaks usual pattern in $3.9 trillion market**

Municipal-bond prices have risen so much that the tax breaks that typically lure investors are washing away.

The yields on top-rated five year state and local government securities are hovering around 0.2%, about one-quarter of what they were a year ago. Even after factoring in the federal tax exemption, that's the equivalent of about 0.3% for the highest-income investors — less than what one would earn on comparable Treasuries. The same goes for benchmark 10-year bonds.

The phenomenon shows how much the $3.9 trillion market has broken from its historic patterns as investors plow billions of dollars into mutual funds focused on state and local government bonds, keeping yields little changed even as those on Treasuries rise. Last week, such funds picked up $3.5 billion of new cash, the most since at least 2007, according to figures from the Investment Company Institute.

The influx is fueling demand for tax-exempt bonds — which are scarcer with interest rates so low that governments are frequently selling taxable bonds to avoid the regulations tied to federally subsidized debt.

Those factors have helped hold municipal-bond yields at record lows against Treasuries, indicating that valuations are at an all time high. With the tax advantages effectively erased when it comes to the safest securities, some money managers have been shifting into taxable bonds instead.

Terry Goode, a senior portfolio manager at Wells Capital Management, said that he's seeing "intense demand" for taxable securities.

"Tax exempt munis are at record rich levels all along the curve and in most rating categories, so if you're able to buy taxable munis, you should be buying taxable munis," Goode said. "Even on an after-tax basis it still makes sense."

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